

Is Value Dead (Again)?

Views From Our Quantitative Team

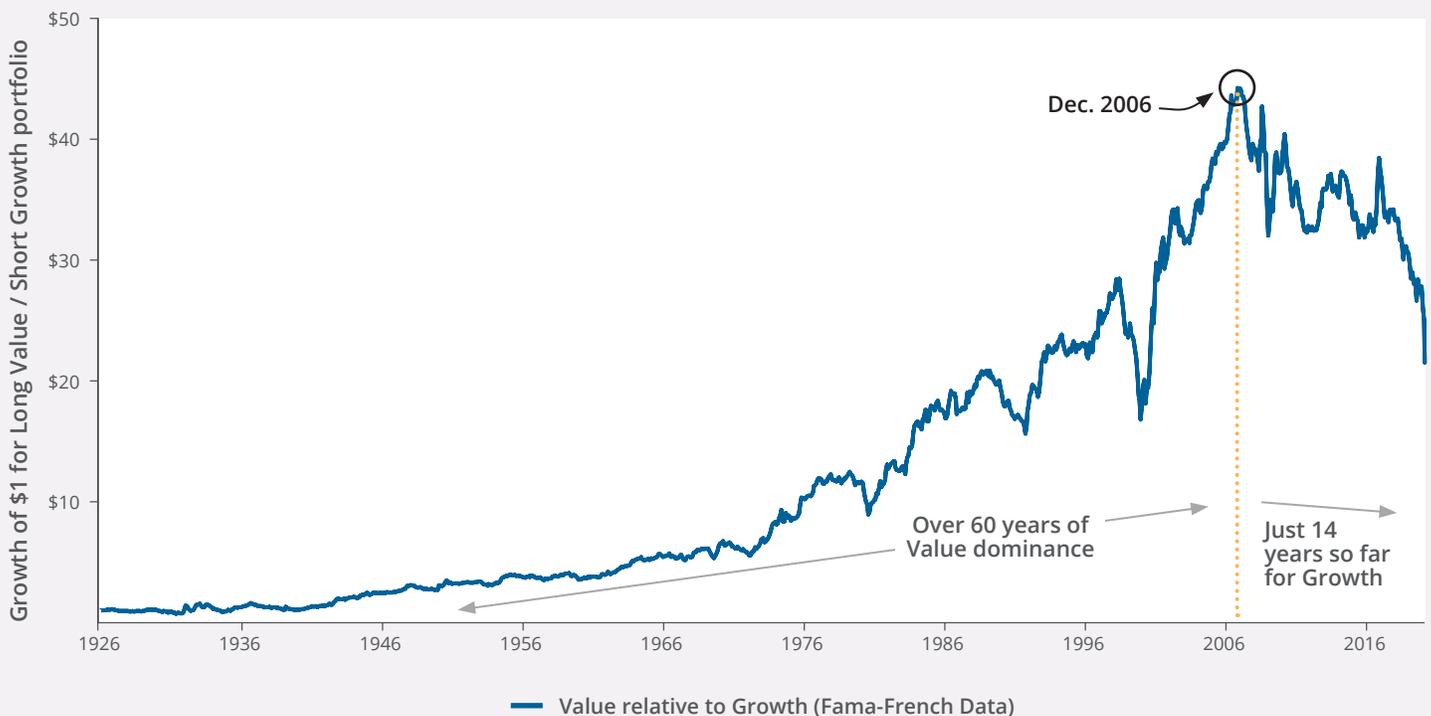
The portfolio managers of the SBH international quantitative strategies discuss the future of Value investing and the current potential of Value versus Growth.

"The reports of my death have been greatly exaggerated (again)." -Value Stocks

Investors around the world have seen unusual moves between Value and Growth stocks over the past few years. Value stocks, those with lower prices relative to their fundamentals (such as book value), have strongly and with a high degree of consistency beaten their Growth peers over history. In order to gain perspective on the persistent dominance of Growth in recent years, some have looked to the long-term history of these investment styles in the U.S. market, in particular to the Fama and French studies¹, which contain relevant data going back to the 1920s. Although many investors see this history as supportive of future Growth outperformance, we think a closer examination of the data points more strongly to a reversal in favor of Value stocks, consistent with a continuation of Value's long-term benefits.

The chart below (Exhibit 1) shows the cumulative outperformance of Value over Growth, which last peaked in 2006. Yet the dramatic advantage for Growth stocks since 2006 (depicted by the curve declining since 2006), has been taken by some to indicate that *"Value has won for most of a century, and now is just the start of a similarly long-lived dominance by Growth stocks."*

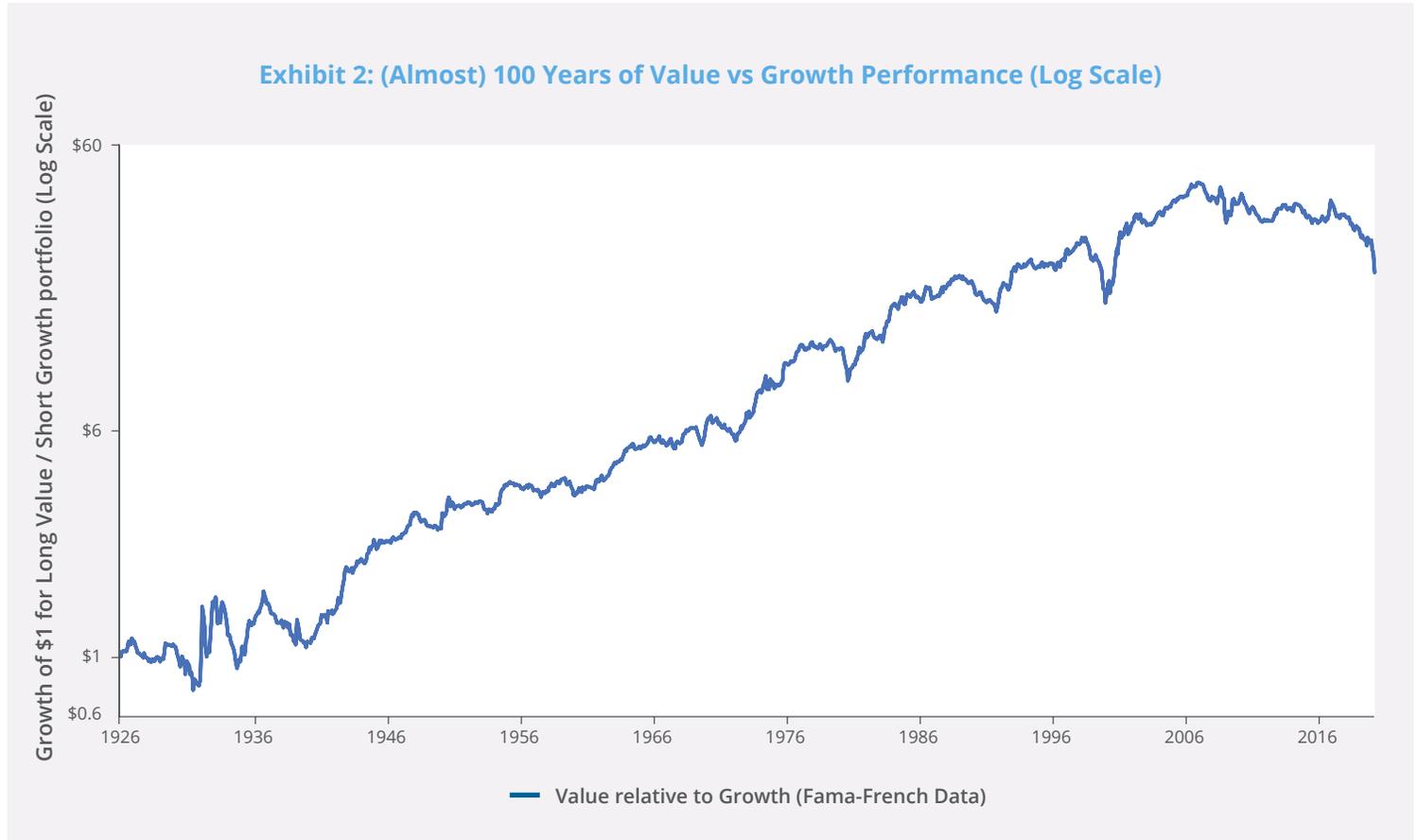
Exhibit 1: (Almost) 100 Years of Value vs Growth Performance



Data from 7/1/1926 to 3/31/2020. Citation Source: Cornerstone Macro, 5/4/2020. The chart reflects the cumulative spread return on a dollar neutral portfolio formed by buying Value and selling Growth. Fama-French 3-Factor Returns on the market cap weighted Center for Research in Security Prices (CRSP) U.S. equity universe. Growth of \$1.00 investment. For more information, please visit http://mba.tuck.dartmouth.edu/pages/faculty/ken.french/Data_Library/f-f_factors.html. Past performance does not guarantee future results.

¹The Fama and French Three-Factor Model is an asset pricing model developed in 1993 that expands on the capital asset pricing model (CAPM) by adding size risk and value risk factors to the market risk factor in CAPM.

Although one can argue the various merits of Value stocks and Growth stocks, as we and many others have done, we believe the simple inference from this chart of strong prospects for Growth is misplaced. Initially, the linear scale showing the long-term Value return advantage gives the impression that the decade or so leading up to 2006 was a period of unnatural or unusual Value advantage that surely warrants reversing. But more properly looking at the chart on a logarithmic scale (in order to better assess growth rates, without the distortion seen in a linear graph, of the later gains compounding on larger base values) (Exhibit 2), one can see that the steady gains that Value has provided over the decades continued at a similar pace up through 2006.



Data from 7/1/1926 to 3/31/2020. The chart reflects the cumulative spread return on a dollar neutral portfolio formed by buying Value and selling Growth. Fama-French 3-Factor Returns on the market cap weighted Center for Research in Security Prices (CRSP) U.S. equity universe. Growth of \$1.00 investment. For more information, please visit http://mba.tuck.dartmouth.edu/pages/faculty/ken.french/Data_Library/f-f_factors.html. Past performance does not guarantee future results.

Reversal or Red Herring?

But what about the drop-off since 2006? Could this be the start of a reversal in favor of Growth justified by many prior decades of Value outperformance? We can get some better perspective by looking at charts showing prior periods when Growth has temporarily outperformed. Exhibits 3-5 show the history from 1926 up to the years 1980, 1991 and 2000, respectively. In each case, one sees a period of reversal from Value leadership that could be taken to indicate a more permanent switch in the long-term leadership from Value to Growth. But, in fact, those three prior endpoints were each the end of a temporary Growth success period as demonstrated by the sharp reversal back to Value dominance seen in the subsequent 5 years periods in red at the right side of each chart.

Exhibit 3: Periods of reversion to Value dominance following temporary Growth leadership

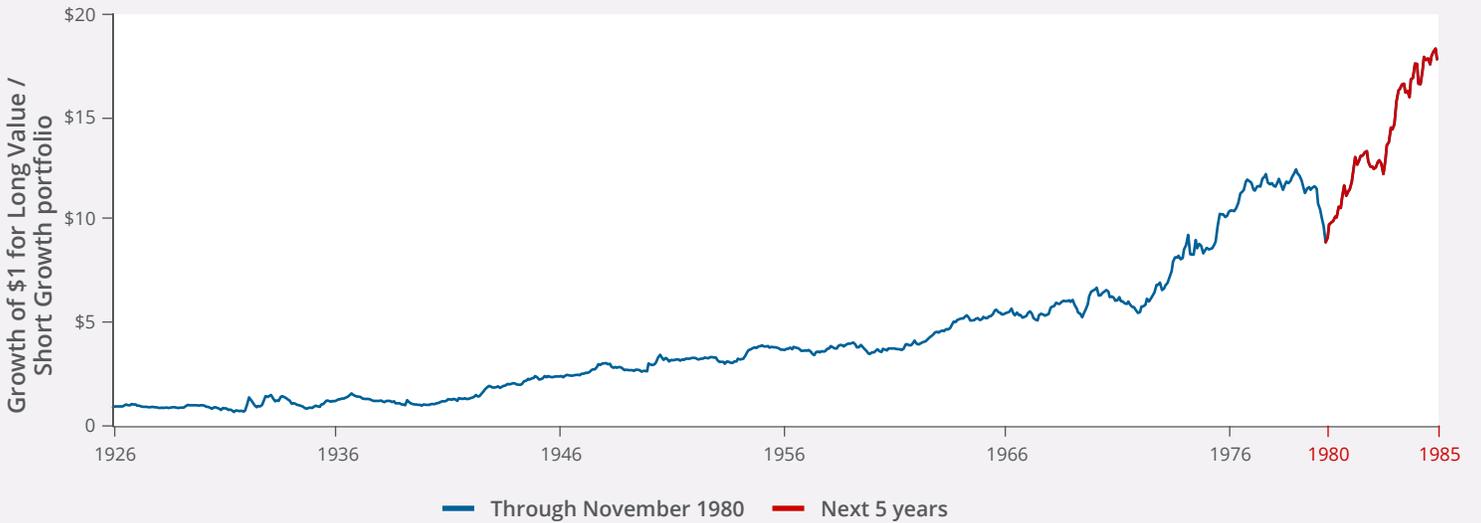


Exhibit 4: Periods of reversion to Value dominance following temporary Growth leadership

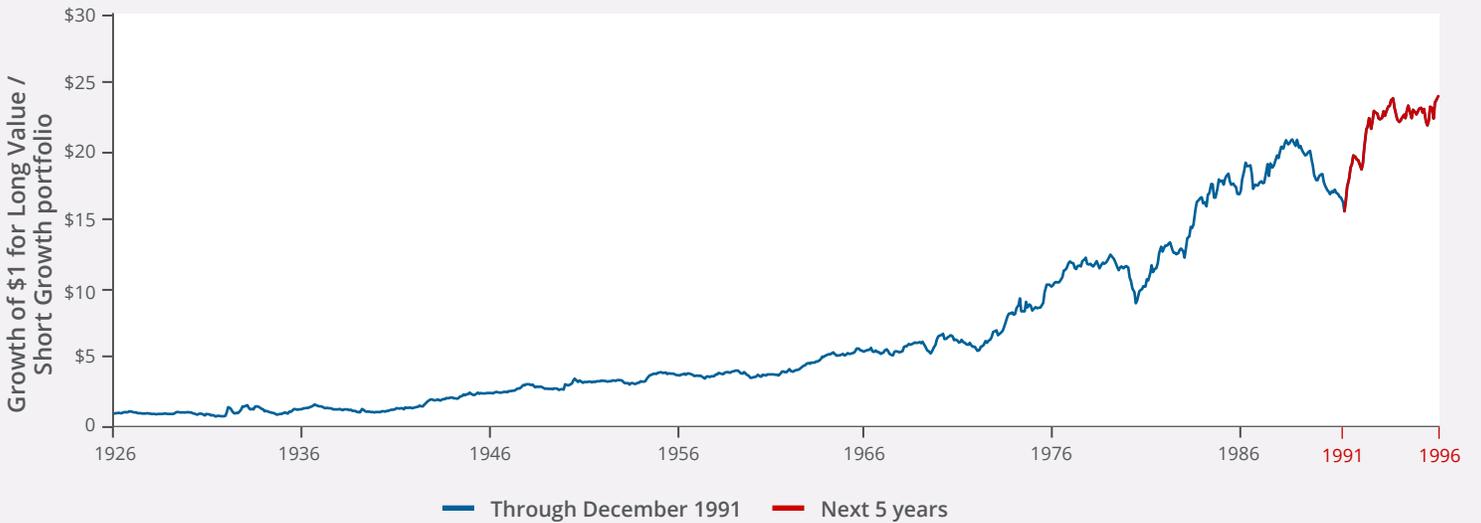


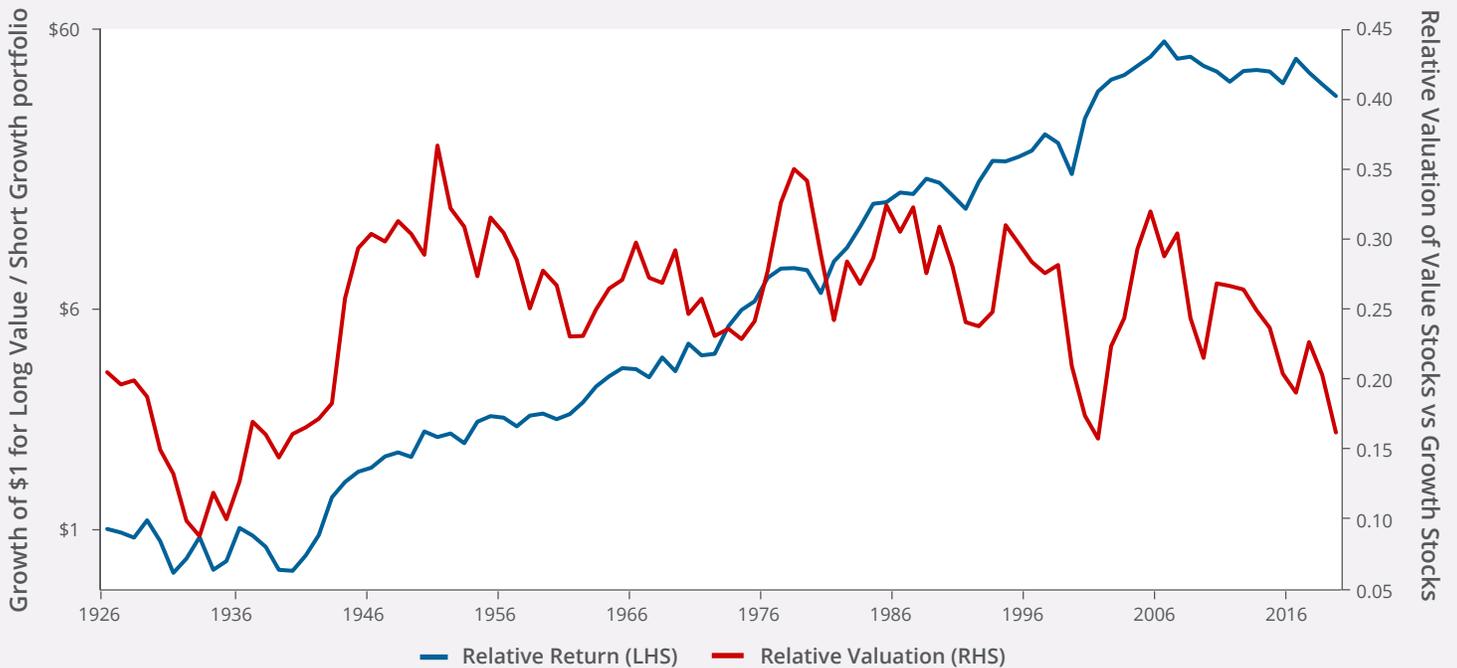
Exhibit 5: Periods of reversion to Value dominance following temporary Growth leadership



Past performance does not guarantee future results.

Although the current period can fit this prior pattern of returns reversing back to Value leadership, an even stronger indication of the potential for such a reversal is the data on valuations themselves. Exhibit 6 shows the annual data version of Exhibit 1 with Value vs Growth relative returns again in blue (left scale) and now with Value vs Growth *relative valuations* (on price to book) in red (right scale). The last datapoint for valuation is nominally 2019, but by the Fama-French methodology it is effectively through December 2018, and therefore does not take into account additional significant growth outperformance and multiple expansion moves since then. Even so, this (not even current) last point shows Value as cheap relative to Growth as it was in 1999 and has otherwise not been as cheap any other time, or even close, since the end of the Great Depression. Numerically, to get back to historical median valuation by price changes alone, Value would need to outperform Growth by 61%. And to get to the “overshoot” valuation peak in 2004, Value would need to outperform Growth by 97%.

Exhibit 6: Relative Returns and Relative Valuations of Value and Growth Portfolios



Data from 7/1/1926 to 3/31/2020. The chart reflects the cumulative spread return on a dollar neutral portfolio formed by buying Value and selling Growth. Fama-French 3-Factor Returns on the market cap weighted Center for Research in Security Prices (CRSP) U.S. equity universe. Growth of \$1.00 investment. For more information, please visit http://mba.tuck.dartmouth.edu/pages/faculty/ken.french/Data_Library/ff-factors.html. Past performance does not guarantee future results. Valuation data is the ratio of the 15th and 85th percentile breakpoints for stocks ranked by book equity to market equity, reflecting the ratio of the median valuations of the Value (top 30%) and Growth (bottom 30%) portfolios.

Given the valuation levels, we believe the chart investors should be focusing on to get a sense of what to expect going forward is not Exhibit 1 (which some interpret to imply many further years of Growth dominance), but instead Exhibit 5 showing the dramatic gains to Value coming off valuation levels in 1999 which we see as similar to current valuations. We believe Value is, in fact, not dead, and may be poised for a period of outsized outperformance relative to Growth, both in the U.S. and international markets. Investors should consider a longer-term perspective when approaching their Value allocations and remain diversified in order to access potential outperformance should history repeat itself (again).

Please reach out to your SBH contact with any questions or visit www.sbhic.com to learn more.

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